BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE REVIEW AND POSSIBLE REVISION OF ARIZONA UNIVERSAL SERVICE FUND RULES, ARTICLE 12 OF THE ARIZONA ADMINISTRATIVE CODE.	Docket No. RT-00000H-97-0137
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	Docket No. T-00000D-00-0672

NOTICE OF FILING

Eschelon Telecom of Arizona, Inc., Mountain Telecommunications, Inc., Electric Lightwave, LLC and McLeod USA Telecommunications Services, Inc. dba PAETEC Business Services hereby give notice that they are filing the attached Direct Testimony of Doug Denney on behalf of Eschelon Telecom of Arizona, Inc., Mountain Telecommunications, Inc., Electric Lightwave, LLC, McLeod USA Telecommunications Services, Inc. dba PAETEC Business Services, tw telecom of arizona, llc and XO Communications Services, Inc. ("Joint CLECS").

RESPECTFULLY SUBMITTED this 1st day of December 2009.

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DIRECT TESTIMONY

OF

DOUGLAS DENNEY

ON BEHALF OF

Eschelon Telecom of Arizona, Inc.; Mountain Telecommunications, Inc.; Electric Lightwave, LLC; McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services; tw telecom of arizona llc; and XO Communications Services, Inc.

December 1, 2009

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Douglas Denney. I work at 1201 NE Lloyd Boulevard, Suite 500, Portland, Oregon.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am Integra Telecom's Director of Costs and Policy. My responsibilities include negotiating interconnection agreements, monitoring, reviewing and analyzing the wholesale costs that Integra Telecom and its affiliates, including Eschelon Telecom of Arizona, Inc., Mountain Telecommunications, Inc., and Electric Lightwave, LLC,[1] pay to carriers such as Qwest, AT&T and Verizon. In addition, I have been involved in policy issues surrounding interstate and intrastate switched access, including filing comments with the FCC regarding its review of intercarrier compensation.[2]

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of Integra, McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services, tw telecom of arizona llc and XO

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1 I will generally refer to the separate Integra Telecom entities in Arizona as Integra.

2 *Comments of Integra Telecom, Inc.*, In the Matter of High-Cost Universal Service Support, Federal-State Joint Board on Universal Service, Lifeline and Link Up, Universal Service Contribution Methodology, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Developing a Unified Intercarrier Compensation Regime, Intercarrier Compensation for ISP-Boand Traffic, IP-Enabled Services, and Number Resource Optimization, Docket Nos. WC 05-337, CC 96-45, WC 03-109, WC 06-122, CC 96-98, CC 01-92, CC 99-68, MG 04-36, and CC 99-200 ("FCC Intercarrier Compensation Docket"), November 26, 2008.

Communications Services, Inc. (collectively, "Joint Competitive Local Exchange Carriers" or "Joint CLECs").

Q. PLEASE DESCRIBE YOUR EDUCATION AND PROFESSIONAL BACKGROUND.

A. I received a B.S. degree in Business Management from Phillips University in 1988. I spent three years doing graduate work at the University of Arizona in Economics, and then I transferred to Oregon State University, where I completed all the requirements for a Ph.D. except my dissertation. My field of study was Industrial Organization, and I focused on cost models and the measurement of market power. I taught a variety of economics courses at the University of Arizona and Oregon State University. I was hired by AT&T in December 1996 and spent most of my time with AT&T analyzing cost models, including the cost of switched access. While at AT&T I worked in the access cost management organization in the western region (the region that includes Arizona and thirteen other Qwest's states). The primary focus of this organization was to achieve access rate reductions across the states in the Qwest region. In December 2004, I was hired by Eschelon Telecom, Inc., which was subsequently purchased by Integra Telecom, where I am presently employed.

I have participated in more than 40 proceedings in the 14-state Qwest region. I testified, for example, as a witness in a recent arbitration proceeding to determine the terms of the contract, known as an interconnection agreement ("ICA"),

between Qwest and Eschelon in Arizona Docket Nos. T-03406A-06-0572 and T-01051B-06-0572,[3] as well as the Qwest-Eschelon ICA arbitration proceedings in Colorado, Minnesota, Oregon, Utah, and Washington. I participated in the underlying ICA negotiations, as well as the arbitrations. I have also testified about issues relating to wholesale service quality (including Performance Indicator Definitions and Performance Assurance Plans) and the wholesale cost of local service (including universal service funding, unbundled network element ("UNE") pricing, geographic deaveraging of UNE prices, and competitive local exchange carrier ("CLEC") access rates).

Q. HAVE YOU PREVIOUSLY TESTIFIED IN ARIZONA?

A. Yes. When with AT&T, I testified in multiple phases of docket T-00000A-00-0194: I testified on geographic deaveraging in Phase I. In Phase II, I supported the HAI Model, which this Commission adopted to set many of the recurring UNE rates in place today. In Phase IIa, I testified about the switching costs included in the HAI Model. I also filed testimony in docket T-00000A-03-0369, the original Triennial Review Order ("TRO") docket, which was stopped after the D.C. Circuit Court remanded parts of the TRO to the FCC. Since I have been with Eschelon, I presented oral comments in docket T-00000I-04-0749 regarding the current state of competition. Most recently, besides the Eschelon-Qwest

[3] *In the Matter of the Petition of Eschelon Telecom of Arizona, Inc., for Arbitration with Qwest Corp., Pursuant to 47 U.S.C. Section 252 of the Federal Telecommunications Act of 1996*, Docket Nos. T-03406A-06-0572 and T-01051B-060572 ("Qwest-Eschelon Arizona Arbitration").

arbitrations mentioned previously, I filed testimony in docket T-03632A-06-0091 on behalf of a number of CLECs addressing key UNE issues arising from the Triennial Review Remand Order, including a review of Qwest's list of Arizona non-impaired wire centers. I also presented oral comments on behalf of Integra at the intrastate access cost workshop associated with this docket, which was held on June 19, 2009.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. My testimony is organized by issue number as contained in the September 29, 2009 Procedural Order.[4]

Q. DO YOU HAVE ANY GENERAL OBSERVATIONS ABOUT THIS PROCEEDING?

A. Yes, I have two observations. First, the Commission should carefully scrutinize the motivations behind the various party recommendations in this docket as the decisions made here can radically alter the industry landscape. For example, Rural ILECs, faced with a continued reduction of access lines and access minutes are glad to replace a falling revenue stream for a more "reliable" source such as a Universal Service Fund ("USF"), much of which would be funded by end users of other local exchange carriers. IXCs such as AT&T and Verizon are simply attempting to reduce the dollars they pay to carriers in Arizona, reducing the cost of their long distance services. With the merger of the largest ILECs with the

[4] *Procedural Order*, September 29, 2009, pp. 4-5.

largest Interexchange Carriers ("IXCs") (i.e. AT&T and Verizon), the disparate voices on switched access rates have turned into a chorus for "reform" that is primarily an attempt by the largest payers of access to reduce their expenses to the detriment of Arizona's local exchange companies ("LECs" – both ILECs and CLECs) and their end-user customers in Arizona. The large IXCs propose to virtually eliminate what they pay today to carriers serving Arizona end-users without any promise of benefit to the Arizona end-users. If the proposals of large IXCs are adopted, their cost reductions will come at the expense of Arizona end-users. CLECs simply request that the Commission refrain from radical change that would force CLECs to alter business plans that they have been implementing over the past ten plus years. CLECs operate in a competitive market that has already been excessively turbulent due to regulatory change, crisis of financial markets and continuous litigation, but CLECs, unlike ILECs, have no prospect of a safe harbor in USF funding.

Second, the Commission should bring a historical perspective to its analysis of the issues in this docket. The Commission should be cautious of taking the radical step of price regulating CLECs – small players in the market whose existence is due to the pro-competitive provisions of the Telecommunications Act of 1996. A decision to ***price regulate CLECs*** would be exceedingly ironic given that the policies that gave birth to CLECs were intended to reduce price regulation. Further, price regulating CLECs would also run counter to (1) the continuing deregulation of the incumbent local exchange carriers ("ILECs") in both retail and

wholesale markets; (2) the Regional Bell Operating Companies ("RBOCs") entry into long distance markets; (3) the lightly regulated megamergers of the largest RBOCs with the largest IXCs; and (4) the emergence of intermodal competition between landline, cable and wireless companies.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. This Commission faces a number of decisions regarding potential changes to intrastate switched access rates. Overlying each of these decisions should be a clear understanding of the impact of these decisions on end-user customers in Arizona, as well the winners and losers created by each determination.

First and foremost, the Commission must decide *which carriers* will fall under mandated changes to intrastate switched access rates.[5] There is universal agreement and a strong desire among the rural carriers that rural carrier access rates be addressed. Disparate opinions emerge regarding the question as to whether Qwest or CLEC intrastate switched access rates should also be reviewed at this time. The Joint CLECs, who pale in size,[6] and thus resources, when compared with the large IXCs and ILECs (AT&T, Verizon and Qwest) prefer that this debate not take place in multiple venues simultaneously. The FCC is intent

[5] Because this proceeding is to address intrastate switched access rates, for the purpose of this testimony I will generally refer to these rates as access rates (or access charges) for simplicity. The term "access rates" generally refers to a wide range of rates in addition to intrastate switched access. In cases when I am discussing ***interstate*** switched access rates or ***special*** access (private line) rates, I will attempt to make the distinction clear.

[6] See table 3 for a comparison of the annual revenues of the Joint CLECs with the annual revenues of AT&T, Verizon and Qwest.

on addressing intercarrier compensation,[7] including potentially intrastate switched access as the large IXCs (AT&T and Verizon) have made significant headway in convincing the FCC to take jurisdiction away from the states. While the large IXCs can afford to press their concerns in every forum available to them in order to achieve additional earnings for their shareholders (through access reduction), the Joint CLECs prefer not to spend scarce financial resources on multiple and potentially duplicative access proceedings. The cost of a proceeding to review access charges and implement possible changes would likely far exceed the benefit of doing so. In fact, CLECs will bear costs grossly disproportionate to their revenues compared to other parties without any prospect of a benefit. From the perspective of Arizona's end-user customers, the regulatory apparatus intended to protect them, will be misused in a shell game that transfers resources from small LECs and Arizona end users to the large IXCs. There is no pressing need to take any action on CLEC access charges at this time and every reason not to.

Second, once the Commission decides what classes of carriers will be involved in changes to access rates, it must decide on the *targeted levels* (benchmarks) for new access rates. The decision essentially boils down to whether the Commission will implement access rate reductions based on (a) a carrier's cost or (b) an arbitrary rate such as interstate switched access rates or Qwest's intrastate

[7] Intercarrier compensation would potentially address all forms of payments between carriers for the exchange of traffic, including reciprocal compensation, interstate switched access and intrastate switched access.

switched access rates. Both interstate switched access rates and Qwest intrastate switched access rates are arbitrary targets for CLECs because neither was established based on any carrier's cost, much less any CLEC's cost. Instead, these rates were the result of deals reached between selected carriers, to their own benefit, without regard to cost, let alone carrier-specific costs. Applying rates developed for the benefit of one specific group of carrier's (such as large ILECs) to another group of carriers, such as CLECs, that typically were neither involved in the development of those rates, nor could foresee that years later results of these negotiations would potentially be forced onto them, is arbitrary and fundamentally unfair. Joint CLECs believe that cost is the only fair benchmark.[8] Yet, if this Commission does decide to mandate CLEC access rate reductions with a target other than cost, then the Commission should establish a benchmark rate equal to Qwest's intrastate switched access rates from the 1999 time period. This is the time period when most CLECs were entering the competitive market and was before Qwest entered into negotiated, revenue neutral, access reductions for its own benefit as a result of the price cap proceedings.

Third, once the set of carriers to which reductions access rates will apply is established and a target rate is selected, the Commission must determine the *transition* process from current access rates to the target rates. AT&T proposes

[8] This recommendation is consistent with position of this Commission, which stated, "The Arizona Commission does not support the adoption of a one-size-fits-all approach with respect to the establishment of reciprocal compensation rates. The rates established by the state commission should reflect the costs of providing the service for the particular carriers involved." Reply Comments of the Arizona Corporation Commission, FCC Intercarrier Compensation Docket, December 22, 2008, p. 15.

the maximum disruption to Arizona end-users and the LECs serving them by proposing immediate changes, a flash-cut, of intrastate access rates to the target established by the Commission. Arizona Local Exchange Carriers Association ("ALECA"), Verizon and Qwest propose a carrier specific transition, but a time frame that is still fairly disruptive, which is no longer than three years. The Joint CLECs propose a more gradual and predictable approach that extends over a number of years. An extended transition period is necessary to minimize impacts on both carriers and their end-user customers and allow carriers the time to alter business plans. The task of altering business plans would be more difficult for CLECs than many rural ILECs: CLECs, by definition, operate in retail markets that are competitive. As a result, CLECs have limited ability to individually increase rates to their end users – in other words they are essentially price-takers in the market. In addition, many CLECs have term agreements with virtually all of their end-user customers that limit the CLECs ability to make rate changes, to the extent they actually had the ability to change these rates. Finally, CLECs may also have term commitment contracts with their wholesale long distance providers (service that CLECs package with their own local service and resell to end users). To accommodate the specifics of CLECs business, CLECs propose that if they are mandated to reduce access rates, the Commission implement the first phase of mandated changes *no earlier than* three years after a decision is made in this docket and then phase in additional changes over a number of years. This will provide the CLECs the ability to fully adjust business plans and contracts and

attempt to mitigate the damage that will be done by reducing CLEC revenue from switched access charges.

Fourth, as part of the transition procedure, the Commission needs to determine whether it will provide carriers with an *alternate revenue source* to offset changes in intrastate switched access. ALECA, AT&T, Verizon and Qwest all propose that reductions in intrastate switched access revenues be recovered from increases to end-user rates and the Arizona Universal Service Fund ("AUSF").[9] These proposals are focused on revenue recovery for rural ILECs. As mentioned previously, CLECs have limited ability to increase rates, unless rate increases are mandated for all CLEC competitors (including the ILECs) – a mandate which would be questionable in a competitive market. Further, CLECs will be unlikely to draw from an access revenue recovery fund, such as a USF, based on limitations typically put in place before a carrier is allowed access to the fund. Finally, it does not make economic or public policy sense to move a revenue source that can be competed away into a revenue recovery mechanism that will likely never be reduced.

Fifth, if a state universal service fund is going to be used to fund changes in switched access revenues for at least some carriers, the Commission must decide the *source of the money* for the fund. Most carriers propose that funding for the

[9] Qwest proposes before a carrier is eligible to draw money from the AUSF it should "first be required to make a showing, either through a R14-2-103 filing, or through a simplified earnings review, that their earnings do not exceed the authorized rate of return." *Qwest Corporation's Reply Regarding Matrix Issues and Procedural Recommendations*, October 7, 2008, p. 2. The Joint CLECs support this proposal.

AUSF be based on intrastate revenues. Qwest clarifies that funding "should come from all sectors of the industry, i.e. ILEC, CLEC, Cable, Wireless and VOIP providers..."[10] It should be noted that IXCs pay intrastate switched access today in order to originate and terminate calls made by IXC customers. Creating a fund based on all carriers' intrastate revenues has the effect of requiring all carriers in the state to subsidize IXCs' customers. In other words, where previously IXCs such as AT&T and Verizon paid rural carriers when AT&T and Verizon's Arizona customers made calls to rural areas, they now propose that CLECs' Arizona end users contribute a share to a fund for the benefit of AT&T's and Verizon's Arizona customers to originate and terminate long distance calls in rural areas. The Joint CLECs find this problematic unless there is a clear showing that the AUSF is for the purpose of *universal service* (rather than a pure benefit of IXCs), and carriers drawing from the fund have demonstrated need as proposed by Qwest. AT&T and Verizon propose mirroring whatever mechanism is used by the FCC to fund the federal USF. This is not surprising since AT&T's and Verizon's federal advocacy is to move USF contributions to a numbers based

[10] *Qwest Corporation's Reply Regarding Matrix Issues and Procedural Recommendations*, October 7, 2008, p. 4.

system.[11] Because IXC operations in a state tend to eclipse the IXC's CLEC operations, the proposal to shift to a numbers based contribution mechanism for USF would provide additional cost savings for IXCs at the further expense of Arizona end user customers.

Finally, if this proceeding is to address CLECs' access rates, then the Joint CLECs recommend the Commission also establish *default rates to be paid to LECs by wireless carriers for termination* of intrastate, intraMTA[12] calls. The FCC recently clarified that states should establish these rates. Because AT&T has expressed concern about different terminating rates, "distorting competition in the telecommunications marketplace,"[13] the Joint CLECs recommend the Commission establish the wireless intrastate, intraMTA rate terminating to CLECs identical to the rate established for terminating intrastate switched access (just as interstate, interMTA rates are identical to CLECs interstate switched access rates).

Q. WHAT ARE THE JOINT CLEC PROPOSALS TO THIS COMMISSION?

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11 A numbers based contribution mechanism would fund the AUSF based on assigned telephone numbers in the state of Arizona. A revenue based contribution mechanism would fund the AUSF based on intrastate revenues. The difference of the two proposals will be based on the relative number of assigned telephone numbers compared with the relative amount of intrastate revenues for each carrier. An advantage of the numbers based contribution mechanism is that it is easier to collect funding from VOIP and wireless providers whose revenue may be difficult to jurisdictionally classify. A disadvantage of a numbers based system as that providers of telecommunications services that have few, or no, assigned numbers (e.g. long-distance service) would not contribute to the fund.

12 IntraMTA calls are calls within a single Major Trading Area ("MTA") – an area that defines "local calling" market of wireless carriers.

13 *AT&T's Issues Matrix and Procedural Recommendations*, October 7, 2008, p. 2.

A. The Joint CLEC recommendations are summarized below:

(1) The Commission should first address rural ILEC access rates before addressing CLEC access rates.

(2) Any target access rate other than cost is arbitrary. To the extent the Commission elects to implement an arbitrary benchmark for CLECs, then Joint CLECs recommend the 1999 Qwest access rates be used.

(3) A transition period should include ample time for a carrier to adjust its business plans. If CLEC access rates are to be reduced, then the Joint CLECs recommend a 3 year period before reductions are implemented so that the CLECs can adjust their business plans and term contracts appropriately. After the three year period, the Joint CLECs recommend rate reductions be phased in gradually over a five to seven year period.

(4) While the Joint CLECs support the concept of universal service, the Joint CLECs are concerned about creation of an access revenue recovery fund. If the AUSF is to be expanded, then the Joint CLECs support the recommendations outlined by Qwest, which provide that funds should only be distributed based upon a demonstration of need and that contributions should come from every provider of telecommunications services.

(5) To the extent CLEC access rates are to be addressed in this proceeding, the Joint CLECs recommend that the Commission also establish the rate for

intraLATA, intraMTA calls terminated by wireless providers to LECs. The rate established by the Commission should equal the intrastate access rate the Commission applies to each CLEC.

II. ISSUES POSED BY THE PROCEDURAL ORDER

Issue 1. What carriers should be covered by access reform?

This Proceeding Should First Focus on Rural LEC Access Rates

Q. AMONG THE MULTIPLE PARTY COMMENTS, IS THERE ONE AREA OF CLEAR AGREEMENT?

A. Yes. All carriers agree, or at least do not oppose, the Commission reviewing and undertaking access reform for the rural ILECs in Arizona. For the purposes of this proceeding carriers in Arizona can be grouped into three groups, non-rural ILECs (i.e. Qwest), rural ILECs, and CLECs. Both AT&T and Verizon propose that all carriers be subject to this proceeding.[14] Qwest and Staff argue that Qwest's access rates should be excluded from this proceeding.[15] ALECA argues that the docket should focus on "preserving and promoting the widespread

[14] See *AT&T's Issues Matrix and Procedural Recommendations*, October 7, 2008, p. 3 and *Verizon's List of Issues*, October 7, 2008, p. 2.

[15] See *Qwest Corporation's Reply Regarding Matrix Issues and Procedural Recommendations*, October 7, 2008, p. 1 and *Staff Response*, April 8, 2009.

availability and affordability of basic local exchange service in rural Arizona."[16] ALECA adds that it does not oppose the inclusion of CLEC access charges, "provided doing so does not distract from the primary focus."[17] The Joint CLECs generally argue that while an investigation of switched access rates in Arizona is premature given discussions that are underway at the FCC, if the Commission is to proceed, it should focus first are rural ILECs.[18]

Given that the Commission is proceeding with this docket, it is clear that one area of agreement among all the parties is that rural ILEC access rates should be reviewed.

The Commission Should Wait Until the FCC Acts on Intercarrier Compensation

Q. DOES THE FCC REALLY PLAN TO ADDRESS INTERCARRIER COMPENSATION?

A. Yes. Just recently the FCC issued a public notice regarding intercarrier compensation and the National Broadband Plan.[19] The FCC requested information regarding "how the current intercarrier compensation system either

16 *Issues Matrix Arizona Local Exchange Carriers Association*, October 7, 2008, p. 1.

17 *Issues Matrix Arizona Local Exchange Carriers Association*, October 7, 2008, p. 1.

18 See *Integra Telecom's Statement of Issues*, October 7, 2008, p. 2; *McLeodUSA's Statement on Issues*, October 7, 2008, p. 2; and *Procedural Recommendations*, filed on behalf of tw telecom and XO, October 7, 2008, pp. 2-3.

19 *Comment Sought on the Role of the Universal Service Fund and Intercarrier Compensation in the National Broadband Plan*, GN Docket Nos. 09-47, 09-51, 09-137, DA 09-2419, Released November 13, 2009.

supports or inhibits broadband deployment, ***rather than conclusory assertions that intercarrier compensation should be reformed.***"[20] Among the information sought by the FCC were minutes and payments for intercarrier compensation over the past three to five years, intercarrier compensation as a percent of total expenses, intercarrier compensation subject to jurisdictional dispute, costs that could be avoided if jurisdictional disputes were eliminated, total minutes of transit traffic, and the impact of intercarrier compensation reform on transit voice and data rates.[21] Initial comments are due on December 7, 2009.[22]

Q. WHY IS FEDERAL INTERCARRIER COMPENSATION REFORM TAKING SO LONG?

A. I suspect that a resolution on intercarrier compensation is taking so long precisely because these are complicated issues, involving a multitude of different carriers, each with its own customer and business interest. The attempt to find a unified solution to all intercarrier compensation issues has likely slowed down the pace of reform. Both the FCC and the Arizona Commission may be best served by dealing first with areas of consensus, such as rural ILEC access rates, rather than attempting to fit the multitude of LECs through the proverbial square hole.

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20 *Id.*, p. 5 (emphasis added).

21 *Id.*, p. 5.

22 *Id.*, p. 1.

Q. IS AT&T'S POSITION THAT THE STATE NEEDS TO ACT QUICKLY TO UNDERTAKE INTRASTATE ACCESS REFORM CONSISTENT WITH ITS ADVOCACY BEFORE THE FCC?

A. No. While AT&T calls on the Arizona Commission to take urgent action on intrastate switched access rates,[23] AT&T is asking the FCC to take jurisdiction over the intrastate switched access and reciprocal compensation rates away from the states. AT&T argues, "It would have been especially perverse for Congress to have authorized the [FCC] to reform intercarrier compensation rules related to 'local' and 'interstate' traffic but not the rules applicable to the one class of traffic – intrastate access – that is subject to the highest above-cost charges... If the Commission lacked authority to establish a national solution for this national problem, the problem would never get fixed."[24] In other words, while AT&T and Verizon[25] ask this Commission and carriers in Arizona to invest the time and resources in addressing intrastate switched access rates, it asks the FCC to take jurisdiction over intrastate switched access rates away from this Commission. While the Joint CLECs believe that this Commission does have jurisdiction over intrastate switched access rates,[26] carriers such as AT&T should not be able to force unwilling carriers to participate in resource intensive and potentially

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23 See *AT&T's Issues Matrix and Procedural Recommendations*, October 7, 2008, p. 2.

24 *Reply Comments of AT&T Inc.*, FCC Intercarrier Compensation Docket, December 22, 2008, pp. 8 and 9.

25 Verizon has also requested that the FCC take jurisdiction of intrastate switched access from state commissions. FCC Intercarrier Compensation Docket, November 26, 2008, p. 9.

26 This position is consistent with the concerns expressed by this Commission. See Reply Comments of the Arizona Corporation Commission, FCC Intercarrier Compensation Docket, December 22, 2008, p. 2.

meaningless proceedings, while AT&T argues for the FCC to remove jurisdiction from the states.

Access Rates of Joint CLECs are Reasonable

Q. BESIDES PENDING FCC ACTION, WHY DO THE JOINT CLECS ARGUE THAT THE COMMISSION NEED NOT TAKE ACTION WITH RESPECT TO CLEC ACCESS AT THIS TIME?

A. There has been no evidence presented that CLEC access rates are in need of review or change. The simple fact that AT&T and Verizon desire increased profitability at the expense of CLECs is not justification for a change in CLEC access rates. No party has demonstrated that CLEC rates are unjust or unreasonable. In fact, one probable reason AT&T and Verizon do not make this claim is that their intrastate switched access rates are virtually identical to CLEC rates. The table below compares the intrastate switched access rates for AT&T and Verizon with the rates for the Joint CLECs.[27]

[27] These rates exclude tandem switching, but include 10 miles of tandem transport, as well as local switching and other per minute charges.

Table 1: Originating and Terminating Access Rate Comparison

LEC	Originating	Terminating	Source Intrastate Tariff
AT&T LEC	$ 0.02803	$ 0.04223	AT&T Communications of the Mountain States Access Services and Network Interconnection Services Price List
Verizon LEC	$ 0.05027	$ 0.07115	MCImetro Access Transmission, Tariff No. 2
Average AT&T and VZ	**$ 0.03915**	**$ 0.05669**	
Integra:			
ELI	$ 0.02990	$ 0.04270	Switched Exchange Access Telecom Services Tariff No. 3
Eschelon	$ 0.02967	$ 0.05241	Access Service Tariff No. 2
Mountain	$ 0.02967	$ 0.05241	Telecommunications Tariff No. 1
McLeodUSA	$ 0.05523	$ 0.05523	Intrastate Access Tariff No. 4
tw telecom	$ 0.03610	$ 0.04409	Intrastate Telecommunications Access Services Tariff No. 4
XO	$ 0.03434	$ 0.04854	Access Service Tariff No. 7
Average JCLECs	**$ 0.03582**	**$ 0.04923**	
Qwest Pre-Price Cap	**$ 0.02803**	**$ 0.04223**	See note below

Current tariffs can be found on the ACC website: http://www.azcc.gov/Divisions/Utilities/Tariff/util-tarrifs-telecom.asp. Qwest's historical access rates are based on Docket No. T-01051B-99-0105 (1999 Price Cap Docket), Testimony of Barbara M. Wilcox on behalf of Qwest, January 8, 1999, Exhibit BMG-5.

As shown in Table 1 above, "JCLECs" (i.e. Joint CLECs) current rates are similar to access rates of AT&T and Verizon in Arizona. The most likely reason that these rates are similar across the various carriers is that these rates were originally set to be similar to the intrastate switched access rates of the incumbent LEC,

Qwest, prior to the two most recent price cap cases. The time period preceding Qwest's price cap cases corresponds with the time when CLECs were establishing business plans and entering the local telecommunications market.

As shown in table 1, Qwest's intrastate switched access rates in 1999, prior to the first price cap reductions, were $0.02803 per originating minute and $0.04223 per terminating minute.[28] With the inclusion of tandem switching, Qwest rates were $0.03478 per originating minute and $0.04898 per terminating minute.

Q. WHY DIDN'T CLECS REDUCE THEIR ACCESS RATES WHEN QWEST REDUCED ITS ACCESS RATES AS A RESULT OF ITS PRICE CAP DOCKETS?

A. There was no reason, or benefit, for CLECs to reduce access rates as a result of Qwest's price cap dockets. During the 1999 Price Cap Docket Qwest and staff entered into a settlement agreement, which was approved by the Commission with modifications.[29] As part of this settlement agreement Qwest agreed to intrastate switched access rate reductions of $15 million spread over a three year period. Qwest was able to make revenue neutral rate increases to offset these

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[28] These rates were calculated in the same manner as the rates in table 1. The individual rate components were taken from the Testimony of Barbara M. Wilcox, Exhibit BMW-5, In the Matter of the Application of U S WEST Communications, Inc. for a Hearing to Determine the Earnings of the Company for Ratemaking Purposes, to fix a Just and Reasonable Rate of Return thereon and to Approve Rate Schedules, Docket No. T-01051B-99-0105 ("1999 Price Cap Docket"), January 8, 1999, Exhibit BMG-5. According to AT&T and Qwest witnesses, Qwest average intrastate switched access rate in Arizona was $.0045 per minute. See *Testimony of Arleen M. Starr on Behalf of AT&T*, 1999 Price Cap Docket, November 13, 2000, p. 2, citing to Testimony of Barbara M. Wilcox on behalf of Qwest.

[29] *Opinion and Order*, 1999 Price Cap Docket, Decision No. 63487, March 30, 2001, p. 26.

reductions.[30] CLEC access rates were not part of this agreement. Nowhere in Qwest's 1999 Price Cap docket were CLEC access rates discussed and there was no notice to CLECs that their rates might be subject to reductions as a result of a settlement agreement entered into by Qwest, for its own benefit.

Likewise, during the 2003 Price Cap Docket,[31] Qwest entered into a settlement agreement with staff, DOD, MCI, TWTA, AUIA, XO and Cox.[32] This agreement called for $12 million in intrastate switched access rate reductions and allowed Qwest to make revenue neutral rate increases.[33] While some CLECs were a party to this agreement, there is no discussion in the docket that these intrastate switched access rate reductions would be applied to CLECs and there was no general notice to CLECs that their rates might be reduced as a result of the 2003 Price Cap Docket.

It would be inappropriate to apply the results of these dockets, or expect CLECs to follow settled results of these dockets when the CLECs were not noticed that the rate changes could extend to them and thus, could not effectively participate and represent their interest in the docket and subsequent settlement discussions.

30 *Opinion and Order*, 1999 Price Cap Docket, Decision No. 63487, March 30, 2001, Exhibit A Settlement Agreement, p. 3.

31 In the Matter of Qwest Corporation's Filing of Renewed Price Regulation Plan, Docket No. T-01051B-03-0454 ("2003 Price Cap Docket").

32 *Opinion and Order*, 2003 Price Cap Docket, Decision No. 68604, August 23, 2005, p. 5.

33 *Opinion and Order*, 2003 Price Cap Docket, Decision No. 68604, August 23, 2005, p. 7.

The Commission Should Also Establish the Terminating Rate for Intrastate, IntraMTA Wireless Calls

Q. IF THE COMMISSION IS GOING TO EXPAND THE SCOPE OF THIS PROCEEDING BEYOND INTRASTATE SWITCHED ACCESS RATES FOR RURAL CARRIERS, WHAT OTHER INTERCARRIER COMPENSATION ISSUES SHOULD THE COMMISSION CONSIDER?

A. If the Commission expands the scope of this docket, it should also establish the rates that wireless carriers pay to LECs to terminate intrastate, intraMTA traffic.

The FCC recently clarified that states should establish these rates following a complaint of a California CLEC, North County Communications Corp. ("North County") against a wireless carrier for failing to pay for terminating traffic originated on the wireless carrier's network and failing to negotiate in good faith an interconnection agreement for the exchange of traffic. The complaint, in part, "asked the Commission to issue an order (i) prescribing a rate (under section 205 of the Act) for terminating intrastate traffic between the parties at or above the rate billed by North County..."[34] The FCC determined, "the California PUC is the more appropriate forum for determining the reasonable compensation rate for North County's termination of intrastate, intraMTA traffic..."[35]

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34 *Order on Review*, North County Communications Corp., Complainant, v. MetroPCS California, LLC, Defendant., File No. EB-06-MD-007, Released November 19, 2009 ("North County Order on Review"), ¶ 9.

35 North County Order on Review, ¶ 12.

As a result, if the Arizona Commission is going to review the CLEC rates for intrastate switched access, it should also establish a default rate for wireless carriers to terminate intrastate, intraMTA traffic to the CLEC. Since carriers such as AT&T have expressed concern about different terminating rates, "distorting competition in the telecommunications marketplace,"[36] the Joint CLECs recommend the Commission establish the wireless intrastate, intraMTA terminating rate identical to the rate established for CLECs for terminating intrastate switched access. This solution would be consistent with the process used today to set the rates for wireless termination of interMTA traffic, for which wireless carriers pay interstate switched access rates.

Issue 2. To what target level should access rates be reduced?

Any Target Other Than The Carrier Cost is Arbitrary

Q. SHOULD CLEC ACCESS RATES BE REDUCED?

A. No. As noted previously, there is no need for reform of CLEC access charges at this time. Intrastate access charges are a diminishing source of revenue due to technological changes and the use of unregulated alternatives for long distance calling. Furthermore, the FCC is proceeding with comprehensive access charge reform that may render any state commission action moot. Finally, the issues faced by CLECs are much different than those faced by rural ILECs.

[36] *AT&T's Issues Matrix and Procedural Recommendations*, October 7, 2008, p. 2.

Q. IF THE COMMISSION DECIDES TO EVALUATE CLEC ACCESS RATES, WHAT TARGET SHOULD THE COMMISSION USE IN THIS EVALUATION?

A. First, there has been no evidence presented in this proceeding that CLEC access rates are excessive or are not just and reasonable. IXC demands to pay less is not evidence that rates need to be reviewed or regulated. If it is determined that CLEC intrastate switched access rates should be review, then most proper basis for review is each CLEC's cost. This Commission stated, "The Arizona Commission does not support the adoption of a one-size-fits-all approach with respect to the establishment of reciprocal compensation rates. The rates established by the state commission should reflect the costs of providing the service for the particular carriers involved."[37] If a carrier has developed a switched access cost study, the Commission should evaluate the carrier's switched access rates in relation to its switched access costs. If and only if the margin (or the difference between cost and rate) of these access rates is much greater than the margins provided by other telecommunications companies, particularly those contained in the underlying wholesale rates (such as special access) of incumbent providers, should the Commission consider mandated changes to a CLEC's intrastate switched access rates. If the carrier has not developed a switched access cost study, the Commission could evaluate the CLEC's rates in comparison to *similarly-situated* carriers. (As explained below,

[37] *Reply Comments of the Arizona Corporation Commission*, FCC Intercarrier Compensation Docket, December 22, 2008, p. 15.

Qwest and other Regional Bell Operating Carriers ("RBOCs") are not similarly-situated to any CLEC.) If and only if CLEC's intrastate switched access rates are outside a zone of reasonableness defined by the switched access rates of similarly-situated carriers (and the CLEC does not have a cost study to justify its rates) should the Commission consider whether the CLEC's intrastate switched access rates should be regulated. In any case, if the carrier develops a cost study at a later date, the CLEC (or any other LEC) should have the right to justify its access rates via a switched access cost study.

Qwest's Intrastate Switched Access Rates Are Not An Appropriate Target

Q. PLEASE EXPLAIN WHY QWEST'S INTRASTATE SWITCHED ACCESS RATES ARE NOT AN APPROPRIATE TARGET WHEN EVALUATING CLECS ACCESS RATES.

A. Qwest's intrastate switched access rates are not an appropriate target or benchmark when evaluating CLEC access rates for two reasons. First, as explained above in relation to Issue 1, Qwest's current intrastate switched access rates were set as a result of negotiations that Qwest agreed to for its own benefit. Qwest reductions in intrastate switched access rates from 2001 forward were made in conjunction with revenue neutral price increases in other rates. The rate reductions voluntarily agreed to by Qwest were implemented in conjunction with Qwest's Price Cap Plan and were correctly not considered appropriate for CLECs.

Second, to the extent Qwest's intrastate switched access rates bear any residual relation to its cost or other financial considerations, these costs or other financial considerations have no relation to CLECs' cost or their other financial considerations.

Q. PLEASE EXPLAIN WHY QWEST'S SWITCHED ACCESS COST HAVE NO RELATION TO CLEC'S COST.

A. CLECs and large ILECs like Qwest have very little in common in terms of their underlying costs and network architectures. First, as new entrants that hold smaller market share than the incumbents, CLECs have a sparser customer base (lower customer density) than large ILECs. As a result, CLECs lag behind ILECs in scale economies because they lack the size necessary to produce average, per-unit costs as low as those enjoyed by large ILECs.

Second, because of their smaller size, CLECs face higher input prices and often a higher cost of capital than large ILECs, who enjoy greater access to capital and the ability to purchase equipment in larger quantities at significant discounts. In addition, because constructing telecommunications facilities is often cost-prohibitive, CLECs lease portions of the ILEC local facilities such as local loop, interoffice transport and collocation space in ILEC central offices. While five years ago, for example, CLECs were able to purchase all of these facilities as unbundled network elements ("UNE") at cost-based prices, prices paid by CLECs for these facilities have increased. These increases result largely from the fact

that the FCC's Triennial Review Order and Triennial Review Remand Order [38] removed the ILEC's obligation to provide unbundled high-capacity loops and transport at UNE (cost-based) prices in certain wire centers, and in some cases capped the quantity of high-capacity facilities CLECs can buy in all other wire centers. Today, in order to lease high-capacity loop and transport facilities in these situations, CLECs have to pay significantly higher, *above cost* rates based on special access tariffs or commercial agreements. In other words, CLECs buy inputs to their switched access service at prices that are significantly higher than input prices faced by Qwest (which are Qwest's own cost of provisioning these inputs/facilities to itself – cost captured by UNE rates).

Third, CLECs tend to have lower facility utilization than large ILECs: While an ILEC's predecessors built the ILEC customer base in protected markets over the course of more than one hundred years, CLECs must deploy some number of these facilities (such as switches) at once before they even begin to attract customers. Because the per unit cost of installing larger facility (such as a large switch) at once is lower than the cost of installing a smaller switch initially and augmenting its capacity as demand grows, it is more economical to install a large

[38] *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability,* CC Docket No. 01-338/96-98/98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, FCC 03-36, Rel. August 21, 2003 ("*Triennial Review Order*" or "*TRO*"). *In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* WC Docket No. 04-313, CC Docket No. 01-338, FCC 04-290, rel. February 4, 2005 ("*Triennial Review Remand Order*" or "*TRRO*").

capacity during the initial deployment. This means that, over much of their economic life, the utilization of CLEC facilities is likely to be substantially below full capacity. Either way, CLECs are faced with either lower utilization or higher per unit costs as they grow their networks and attract customers. In contrast, when an ILEC installs a new digital switch or replaces a transport route with more efficient technology, it normally does so to replace existing facilities that are already highly utilized. This means that, typically, from the moment the ILEC installs a new facility, it will be highly utilized. In other words, ILECs have higher capacity utilization of their switched access facilities due to their dominant incumbent position as keeper of the public switched telephone network.

Next, the typical CLEC network design is materially different than Qwest's network design (or network of any other large ILEC) because the economics of deploying a competitive network is substantially different than the economics of deploying a network designed to serve a much denser ILEC customer base: For example, Qwest's network is hierarchical and consists of multiple wire centers (local switches) placed to aggregate traffic of a relatively dense customer base and transport to a hierarchical tandem office. CLEC's network consists of fewer switches and substantially increased levels of transport and traffic aggregation facilities. This network architecture is sometimes referred to as "distributed" architecture, as opposed to the ILECs "hierarchical" architecture. To provide a more specific example, a CLEC would typically deploy one switch to serve a large market, such as Phoenix Metropolitan Statistical Area ("MSA") (a switch

that combines functionalities of a local and tandem switch), while Qwest has over 60 switches in this MSA.

Last, CLECs experience an additional cost component in offering switched access services that is not experienced by the ILECs: collocation. Most CLECs connect to their end users through ILEC owned collocation facilities. Thus, even if CLECs and ILECs were to have identical costs for all other service components – and they don't – CLECs would incur higher costs because their switched access services involve collocation. In other words, even if a CLEC were to be as efficient as the ILEC in the provision of switched access, its costs would still be higher.

Q. WHAT ARE THE COST IMPLICATIONS TO CLECS' DIFFERENT, DISTRIBUTED NETWORK ARCHITECTURE?

A. The advantage of this architecture is that it minimizes the amount of switching and central office investment required to serve a more dispersed customer base, both by minimizing the number of local switches, and eliminating the need for a stand-alone tandem switch. The tradeoff is that this network architecture requires substantial additional investment in transport and collocation facilities necessary to aggregate traffic and deliver it to the centralized switch. Because transport and aggregation equipment must be sized in relation to the amount of traffic it supports, most of the costs of these additional network components relied upon by CLECs are *traffic sensitive* in nature, thereby generating *traffic sensitive costs*.

Recall that usage-based switched access rates are, in general, intended to recover the traffic sensitive costs LEC incurs in accommodating the long distance traffic of IXCs. Because CLEC networks tend to deploy more traffic sensitive investment as compared to ILEC networks (which rely more heavily on ubiquitous loop facilities to aggregate traffic to multiple, local switches), it follows that CLECs have more traffic sensitive costs to recover via their switched access rates compared to ILECs.

RBOCs Interstate Switched Access Rates Are Not An Appropriate Target

Q. WHY IS IT INAPPROPRIATE TO USE QWEST (OR OTHER RBOCS) INTERSTATE SWITCHED ACCESS RATES AS A TARGET OR BENCHMARK FOR CLEC INTRASTATE SWITCHED ACCESS RATES?

A. It is inappropriate to use RBOCs interstate rates for the same reasons that it is inappropriate to use Qwest's intrastate switched access rates as a target – these rates were set as a result of negotiations between RBOCs and IXCs (negotiations in which, as explained below, neither CLECs, nor this Commission were a party or beneficiary of), and that to the extent these rates contain any residual relationship to the RBOCs cost or other financial considerations, these costs and financial considerations have no relation to CLECs' costs and CLECs' financial considerations.

Q. IS THE FCC'S *CALLS ORDER* – A LANDMARK ORDER PERTAINING TO RBOCS INTERSTATE ACCESS RATES – A GOOD EXAMPLE OF WHY ILEC RATES ARE SO INAPPROPRIATE FOR CLECS?

A. Yes. In this Order (dated May 31, 2000), the FCC adopted an "integrated interstate access reform and universal service proposal" put forward by AT&T, Bell Atlantic, GTE, SBC and Sprint (referred to by the FCC as the Coalition for Affordable Local and Long Distance Service – CALLS).[39] The *CALLS Order* substantially altered interstate switched access rates for all price cap carriers (including Qwest). The primary focus was to reduce interstate access rates paid by IXCs, while at the same time allowing price cap LECs (including Qwest) to recover those same monies through the interstate universal service support mechanism (*i.e.*, largely a revenue neutral undertaking for the ILECs).[40]

Q. HOW WERE THE ILEC INTERSTATE ACCESS RATES SET IN THE *CALLS ORDER*?

A. The access rates produced by the *CALLS Order* were set through a *negotiated* agreement reached by the ILECs and IXCs. These behind the scenes negotiations are revealed in a dissent by then FCC Commissioner Harold Furchtgott-Roth.[41] In his dissent, Commissioner Furchtgott-Roth expressed his opinion that "the

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[39] *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers,* CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, *Low-Volume Long Distance Users,* CC Docket No. 99-249, Report and Order, *Federal-State Joint Boards on Universal Service,* CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962 (2000) (hereafter *"CALLS Order"*).

[40] *CALLS Order*, ¶¶29-35, especially, ¶¶30 and 32.

[41] *Statement of Commissioner Harold Furchtgott-Roth, Concurring in Part and Dissenting in Part,* appended to the *CALLS Order*, May 21, 2000 (*"Furchtgott-Roth Dissent"*).

process by which the original CALLS proposal was modified [and ultimately approved] is fundamentally inconsistent with principles of neutrality and transparency that must govern agency decision making."[42] Specifically, the Furchtgott-Roth Dissent reveals two important aspects of this process:

> [A] number of parties with interests in the outcome of this proceeding, including the Ad Hoc Telecommunications Users Committee, Time Warner Telecom, and the Association for Local Telecommunications Services, were not allowed to participate.[43]

> [P]roceedings that were unrelated to the issue of access charge reform became part of the negotiations. Incumbent local exchange carrier members of the Coalition apparently contended that they could not commit to certain modifications of the CALLS proposal unless they had confidence that two separate matters – a depreciation waiver item and the pending special access proceeding, which concerns the circumstances in which carriers may purchase combinations of unbundled loops and transport network elements – would be resolved favorably to them. As a consequence, part of the final agreement reached by the participants to the CALLS negotiations concerned these two separate matters. With respect to this depreciation item, the Bureau agreed to recommend to the Commission that it approve the waiver that is the subject of this Notice and terminate the CPR audits. Additionally, the Bureau agreed to recommend to the Commission that it "clarify" the existing rules regarding special access and defer further rulemaking until 2001.[44]

Q. DOES THE ABOVE DISCUSSION SHOW THAT THERE IS NO SOLID COST FOUNDATION FOR THE ILEC INTERSTATE ACCESS RATES THAT CAME OUT OF THE CALLS ORDER?

A. Yes. The RBOCs' access rates resulting from the CALLS Order were established through a "closed door" negotiated settlement between parties allowed the benefit

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42 *Statement of Commissioner Harold Furchtgott-Roth, Concurring in Part and Dissenting in Part*, appended to the *CALLS Order*, May 21, 2000 ("*Furchtgott-Roth Dissent*").

43 *Furchtgott-Roth Dissent.*

44 *Furchtgott-Roth Dissent* (footnotes omitted).

of participating, each with its own agenda and objectives, some of which had nothing to do with switched access. The Commission should not compound the problem for CLECs by adopting as a CLEC intrastate benchmark a rate level that was established without any CLEC input, particularly given the arbitrary manner in which these levels were established.

Benchmarked Rates Will Possibly Be Confiscatory

Q. DO PROPOSALS TO CAP CLEC ACCESS RATES RUN INTO DANGER OF BEING CONFISCATORY AND HARMFUL LOCAL COMPETITION?

A. Yes. For almost a century it has been a standard principle in public utility regulation that rates – when regulated – be set at levels that allow a company a reasonable opportunity to recover the costs of providing the regulated service, otherwise they are confiscatory.[45] In New Jersey, in a switched access proceeding much like this one, Verizon witnesses forewarned the New Jersey Board to not set rates at confiscatory levels by referring to Brooks-Scanlon Co. v. Railroad Comm'n, 251 U.S. 396 (1920), where the United States Supreme Court barred exactly what some parties are seeking here – service at a price less than the cost to provide that service. [46] Further demonstrating the inappropriateness of such

[45] In this section, I use "confiscatory" and "confiscation" not as a legal terms but as they are used in common speech.

[46] In the Matter of the Board's Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates, State of New Jersey Board of Public Utilities Docket No. TX08090830, Exhibit Verizon- 1P, Initial Testimony of Paul B. Vasington and Thomas J. Mazziotti, p. 45.

advocacy for benchmarks, Verizon proceeded to quote Justice Holmes stating that a company cannot "be compelled to spend any other money to maintain [the enterprise] for the benefit of others who do not care to pay for it."[47]

The FCC, in establishing the price cap regime for LECs, likewise recognized that below-cost rates would be confiscatory:

> [A] price cap LEC may petition the Commission to set its rates above the levels permitted by the price cap indices based on a showing that the authorized rate levels will produce earnings that are *so low as to be confiscatory.*[48] (Emphasis added.)

The Commission should note that benchmark policies are deeply disruptive of the CLECs' ability to compete. While exchange access rates are generally compensatory for ILECs, benchmarked rates typically are not for CLECs; as such, they will leave a significant portion of the CLECs' costs to go unrecovered. This is unfair and, as noted, possibly confiscatory.

Further, benchmark policies will not serve ratepayers well. CLECs may be forced to forfeit millions of dollars when IXCs gain access to their networks at below cost rates. The suggestion that CLECs can recoup those costs from end users, offered by advocates of benchmark policies, is wrong: CLECs do not have a base of monopoly rate payers on whom to foist cross-subsidies and competitive retail markets do not permit arbitrary markups for unrecovered costs. While the IXCs

47 *Id.*

48 *CALLS Order*, ¶ 17.

will improve their bottom line, this permanent drain on CLEC resources will invariably curtail the CLECs' ability to expand their networks and compete vigorously, to the ultimate detriment of telecom markets and end user customers in Arizona.

The FCC Never Intended to Have States Follow Its Policies

Q. DOES THE FCC HAVE A BENCHMARK POLICY FOR CLEC INTERSTATE ACCESS RATES?

A. Yes. The FCC adopted a transitional benchmarking policy for CLEC access rates in its 2001 *CLEC Access Charge Order,*[49] which capped the CLEC interstate access rates to the rate of the ILEC with which the CLEC competes.[50]

Q. WHY IS IT INAPPROPRIATE TO APPLY THE FCC'S FINDINGS MADE IN THE ORDER ISSUED IN 2001 TO THE SITUATION IN ARIZONA TODAY?

A. The findings in the FCC's 2001 Order were explicitly transitional and, since that time, changes have taken place in the telecommunications marketplace that show that the transitional mechanism adopted by the FCC for interstate access eight years ago is not warranted in Arizona today.

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[49] *In the Matter of Access Charge Reform,* Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262; FCC 01-146, April 27, 2001 ("*CLEC Access Charge Order*").

[50] *CLEC Access Charge Order,* ¶52.

Q. PLEASE ELABORATE ON YOUR STATEMENT THAT THE FCC'S BENCHMARKING POLICY WAS EXPLICITLY TRANSITIONAL.

A. The FCC specifically stated that its benchmark was *transitional.* The FCC said:

> We stress, however, that the [benchmark] mechanism set out below is a *transitional* one; it is not designed as a permanent solution to the issues surrounding CLEC access charges. Rather, we view the mechanism we adopt today as a means of moving the marketplace for access services closer to a competitive model. Because our tariff benchmark is tied to the incumbent LEC rate, we will re-examine these rates at the close of the period specified in the *CALLS Order.* Through a separate notice of proposed rulemaking that we issue today, we also evaluate the access charge scheme as part of a broader review of inter-carrier compensation.[51]

As explained in ¶19 of the *CLEC Access Charge Order,* "[t]he *CALLS Order* is interim in nature, covering a five-year period; its reforms became effective on July 1, 2000."[52] Though the FCC is currently engaged in efforts to comprehensively address inter-carrier compensation issues, the FCC has yet to take action more than eight years later. As explained below, market developments that have taken place since the FCC instituted its interstate benchmark in 2001 no longer warrant price regulation or the imposition of a cap on CLEC access rates (even if assuming for the sake of argument that such a cap was warranted in 2001 in the first place).

Q. WHAT CHANGES IN THE TELECOMMUNICATIONS INDUSTRY HAVE OCCURRED SINCE 2001 THAT MAKE A CLEC ACCESS RATE CAP UNWARRANTED?

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[51] *CLEC Access Charge Order,* ¶7. (Emphasis added)

[52] Footnote omitted.

A. In its *CLEC Access Charge Order*, the FCC noted that in an earlier order, it had recognized the presumptively competitive nature of CLEC exchange access services:

> [A]s CLECs attempted to expand their market presence, the rates of incumbent LECs or other potential competitors should constrain the CLECs' terminating access rates. The Commission found that access customers likely would take competitive steps to avoid paying unreasonable terminating access charges. Thus, it explained that a call recipient might switch to another local carrier in response to incentives offered by an IXC.[53]

When the FCC revisited the issue in its 2001 *CLEC Access Charge Order*, it came to a somewhat different conclusion. The FCC noted:

> We decline to conclude, in this order, that CLEC access rates, across the board, are unreasonable. Nevertheless, there is ample evidence that the combination of the market's failure to constrain CLEC access rates, our geographic rate averaging rules for IXCs, the absence of effective limits on CLEC rates and the tariff system create an arbitrage opportunity for CLECs to charge unreasonable access rates. Thus, we conclude that some action is necessary to prevent CLECs from exploiting the market power in the rates that they tariff for switched access services.[54]

However, while the FCC concluded in 2001 that CLECs may have been able to exploit market power, it is important to note that the FCC identified *two developments* that would make exchange access (or switched access) markets competitive:

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[53] *CLEC Access Charge Order*, ¶14 (footnotes omitted), referencing *In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing End User Common Line Charges;* First Report and Order, CC Docket No. 96-262; CC Docket No. 94-1; CC Docket No. 91-213; CC Docket No. 95-72; FCC 97-158, 12 FCC Rcd 15982; 1997 FCC LEXIS 2591, May 16, 1997 ("*Access Charge Reform Order*").

[54] *CLEC Access Charge Order,* ¶34 (footnote omitted).

> The Commission previously projected that, at least in the case of originating access service, IXCs would likely enter marketing alliances with LECs offering low-priced access service and would thereby be able to exert downward pressure on CLEC access rates. The Commission even raised the prospect that IXCs would themselves choose to enter the local service market as a means of exerting downward pressure on terminating rates.[55]

That is, according to the FCC, exchange access markets would discipline CLEC exchange access rates if the following occurred: (1) alliances between IXCs and ILECs and (2) IXC entry into local exchange markets. In 2001, the FCC lamented that neither of these developments had yet come to pass and, accordingly, the FCC concluded that CLECs must have market power in the provision of exchange access services.[56] Of course, what the FCC was hoping for in 2001 in order to make access services competitive – (1) alliances between IXCs and ILECs and (2) IXC entry into local markets – now *has* come to pass. So, while the FCC has yet to modify its "transitional" mechanism (in large part due to all of the other intercarrier compensation issues on which the FCC has yet to take action), it should not be viewed as an indication that a state commission should follow suit on the intrastate level, as doing so would apply an outdated regulatory "fix" to a marketplace that is significantly different than the market for which the "fix" was designed.

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55 *CLEC Access Charge Order,* ¶32 (footnotes omitted).

56 *CLEC Access Charge Order,* ¶32 states as follows: "However, neither of these eventualities has come to pass, at least not to an extent that has resulted in effective downward competitive pressure on CLEC access rates. We now acknowledge that the market for access services does not appear to be structured in a manner that allows competition to discipline rates."

Q. HOW HAVE THESE PRECONDITIONS FOR A FUNCTIONING ACCESS MARKET SINCE COME TO PASS?

A. All RBOCs have obtained Section 271 approval to provide interLATA long distance services, and perhaps more importantly, there have been a number of mergers between major IXCs (and CLECs) and ILECs – most notably the mergers between AT&T and SBC and between Verizon and MCI.[57] These changes have transformed the traditional ILECs into vertically-integrated firms offering both local and long distance services (including competitive local exchange services in Arizona). These changes brought about by Section 271 approvals and the mergers impact rebut any suggestion that CLECs might exercise market power and prevent IXCs from entering the market.

It is Standard Regulatory Practice to Set Wholesale Rates Based on Company Specific Costs

Q. HOW DO REGULATORS TYPICALLY SET REGULATED WHOLESALE RATES FOR LECS?

A. It is standard practice to set regulated rates for wholesale services based on company specific costs. This is true for all wholesale services offered by ILECs under Section 251 of the Telecommunications Act of 1996: UNE rates for all unbundled network elements are to be set at company specific TELRICs. Most

[57] Qwest-Arizona obtained Section 271 authority in 2003. SBC and AT&T merged in 2005. Verizon and MCI merged in 2005.

other regulated wholesale services offered by ILECs have also been set in reference to those companies' own costs, and not based on proxy companies.

Q. ARE SWITCHED ACCESS SERVICES WHOLESALE SERVICES?

A. Yes. And as such – and in line with standing practices – if the Commission decides to regulate CLEC switched access rates, rates for switched access services should be set at company specific costs.

The IXCs' Calls to Reduce CLEC Access Rates Are Hypocritical and Self-Serving

Q. WHY ARE THE IXCS' CALLS TO REDUCE CLEC ACCESS RATES IN ARIZONA ARE HYPOCRITICAL AND SELF-SERVING?

A. They are hypocritical and self-serving for three reasons. First, IXCs in question (AT&T and Verizon) appear to forget that they are vertically and inter-modally integrated companies – companies that are the two *largest* ILECs, the two *largest* wireless carriers and what used to be the two most vocal (in the regulatory arena) CLECs in the nation. AT&T is complaining that "[o]ne CLEC has intrastate terminating access charges of over 4.2 cents per access minute, while its corresponding interstate charges are less than half a penny."[58] AT&T neglects to mention that *its own* CLEC intrastate switched access rate in Arizona is also "over

[58] *Comments of AT&T* dated January 7, 2008, p. 2.

4.2 cents" per terminating minute,[59] while its interstate charges are also "less than half a penny."[60] If AT&T were sincere in its concerns that 4.2 cent per minute rates are high and "[t]he implicit subsidies in switched access rates and the economic reactions that they trigger are harming Arizona consumers and the Arizona telecommunications market[,]" [61] AT&T could have reduced its own CLEC intrastate switched access rates in Arizona to the levels it is advocating. Of course, AT&T is not willing to forgo its switched access revenue.

Verizon argues, "economically efficient competition and the consumer benefits it yields cannot be achieved as long as carriers seek to recover a disproportionate share of their costs from other carriers, rather than from their own end users."[62] Yet it fails to mention that this is exactly what Verizon seeks to do. Verizon (and AT&T) advocate that the rates they pay to use a carriers network be shifted from the IXC and onto all customers and carriers doing business in Arizona, whether or not they are using the network that is being utilized by the IXC. Shifting expense

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59 See *AT&T Communications of the Mountain States, Inc. Arizona Access Services And Network Interconnection Services Price List*, p. 22. AT&T's composite terminating rate is $ 0.04223, calculated as the sum of the following three tariff rates: terminating switching charge ($0.041500 per minute), tandem transport terminating per minute charge ($0.000480) and tandem transport facility per minute-mile charge (0.000025) assuming 10 mile transport. Note that AT&T's composite originating rate is $0.02803, calculated as the sum of the originating switching charge ($0.027300 per minute) and the above listed tandem transport termination and facility charges. These rates are summarized in table 1.

60 *Comments of AT&T* dated January 7, 2008, p. 2. AT&T's CLEC interstate access rates can be found in AT&T Communications Tariff FCC No. 28 at:
http://www.serviceguide.att.com/ABS/ext/doc/Tariff%2028%20Master%20v741.pdf

61 *Comments of AT&T* dated January 7, 2008, p. 7.

62 *Verizon's Reply Comments*, February 4, 2008, p. 3.

from the cost causer, the IXC, to all carriers and their end users in Arizona is exactly the action of which Verizon warns.

Second, AT&T's concern that switched access rates are "in excess of the rates necessary to adequately recover costs"[63] is hypocritical because many of its own rates are above cost and/or above AT&T cost estimates. One example is AT&T's advocacy in the Federal intercarrier compensation docket, where AT&T filed a letter stating that the per-minute switching costs for carriers should be in the range between $0.00010 and $0.00024 per minute.[64] AT&T's own switched access rates for local switching element are significantly higher: As mentioned above, in Arizona AT&T's intrastate access local switching rate is $0.041500 per terminating minute and $0.02803 per originating minute,[65] which is between *one hundred* and *four hundred* times[66] higher than AT&T's own cost estimates for this functionality. Also higher than its cost estimates are interstate switched access rates of AT&T RBOC companies: Compare the above mentioned AT&T cost estimates (between $0.00010 and $0.00024 per minute) to AT&T interstate local

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63 *Comments of AT&T* dated January 7, 2008, p. 7.

64 Letter from Henry Hultquist, Vice President-Federal Regulatory, AT&T Services, Inc. to Marlene H. Dortch, Secretary, Federal Communication Commissionin dockets *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *High-Cost Universal Service Support*, WC Docket No. 05-337; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Intercarrier Compensation for ISP-Bound Traffic*, WC Docket No. 99-68; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135 dated October 13, 2008, p. 5.

65 *AT&T Communications of the Mountain States, Inc. Arizona Access Services And Network Interconnection Services Price List*, p. 22.

66 Calculated as $0.02803 divided by $0.00024 (=117 times) and $0.041500 divided by $0.00010 (=415 times).

switching rates of $0.003133 (SNET, Connecticut),[67] $0.003116 (Ameritech region),[68] $0.00262 (Pacific Bell),[69] $0.002563 (SWBT region),[70] and $0.002158 (BellSouth region). [71] These rates are *by an order of a magnitude* higher than AT&T cost estimates, meaning that by AT&T's own account, its interstate access local switching service brings margins in the vicinity of *one thousand percent.*[72] However, AT&T has not argued that its own CLEC rates are excessively high, unjust, unreasonable, or in urgent need of reduction through regulation.

Note that Qwest's interstate access local switching rate is $0.001974,[73] meaning that based on AT&T cost estimates, Qwest's interstate rate contains at least a 700% margin (=$0.001974/$.00024 - 1).

Third, while Verizon and AT&T advocate that this Commission not wait for the FCC to act on intercarrier compensation, they have the exact opposite position with respect to the AUSF recovery mechanism. AT&T and Verizon ask this Commission to follow any actions taking by the FCC with regard to funding universal service.[74] This advocacy is a result of AT&T's and Verizon's proposal

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67 See *SNET Tariff FCC No. 39*, Section 6, p. 6-64.

68 See *Ameritech Tariff FCC No. 2*, Section 6, p. 214.

69 See *Pacific Bell Tariff FCC No. 2*, Section 6, p. 6-220.

70 See *SWBT Tariff FCC No. 73*, Section 6, p. 6-185.

71 See *BellSouth Tariff FCC No. 1*, Section 6, p. 6-161.

72 Margin is defined as a ratio of rate and cost minus 1. For example, for Ameritech, interstate local switching rate of $.003116 in combination with the upper boundary of AT&T local switching cost estimate ($0.0024) produces are margin of 1,198% (=$0.003116 divided by $0.0024 minus 1).

73 See *Qwest Tariff FCC No. 1*, Section 6, p. 6-433.

74 See *AT&T's Issues Matrix and Procedural Recommendations*, October 7, 2008, p. 5 and *Verizon's List of Issues*, October 7, 2008, p. 4.

before the FCC to move USF contribution to a numbers based system. Because IXC operations in a state tend to eclipse the IXC's CLEC operations, the proposal to shift to a numbers based contribution mechanism for USF would provide additional cost savings for IXCs at the further expense of Arizona end user customers.

Q. ARE THERE ANY OTHER EXAMPLES THAT ILLUSTRATE THAT RBOCS RATES FOR CRUCIAL SERVICES SIGNIFICANTLY EXCEED THEIR COST?

A. Yes. Special access services are a good example. Traditionally, IXCs and large business end-users were the typical buyers of these services. More recently, following the TRO and TRRO (which removed the ILECs' obligation to provide a number of UNE products such as high-capacity loops and transport at many wire centers) these services became essential wholesale inputs for CLECs. Special access services are priced significantly above the underlying economic cost, as evidenced by a comparison of TELRIC-based rates for ILEC UNE services with the rates for their special access counterparts.

Specifically, the following table illustrates this point by presenting "margins" by which Qwest Arizona and AT&T Illinois (picked as an example of AT&T companies) special access rates exceed the UNE rates of their functional equivalents. Here "margins" are defined as a ratio between a special access rate and UNE rate minus one. Because UNE rates are set based on TELRIC cost plus

shared and common cost, the calculated "margins" represent the degree by which special access prices exceed economic cost (cost that include capital cost, expenses and reasonable profit). For example, a margin of 63% means that special access rate is equal to UNE cost-based rate plus a 63% markup, or, equivalently, that special access rate is 1.63 times higher than the corresponding UNE rate.

Table 2. Margins by Which RBOCs Special Access Rates Exceed Comparable UNE Rates*

Network Element / Service	Qwest Intrastate over UNE		Qwest Interstate over UNE		AT&T Illinois Interstate over UNE	
	Monthly	60-Mo. Term	Monthly	60-Mo. Term	Monthly	60-Mo. Term**
DS1 Loop / Local Distribution Channel						
Lowest Zone	123%	63%	145%	63%	802%	308%
Highest Zone	97%	45%	143%	71%	495%	184%
DS1 Transport -- Termination						
Lowest Zone	456%	289%	156%	122%	462%	75%
Highest Zone	456%	289%	156%	122%	522%	254%
DS1 Transport -- Mileage						
Lowest Zone	1496%	1070%	1602%	964%	1331%	815%
Highest Zone	1496%	1070%	1602%	964%	1863%	852%
DS3 Transport -- Termination						
Lowest Zone	141%	93%	164%	83%	308%	63%
Highest Zone	141%	93%	164%	83%	383%	121%
DS3 Transport -- Mileage						
Lowest Zone	121%	77%	435%	328%	524%	13%
Highest Zone	121%	77%	435%	328%	675%	64%

** – Derived from Qwest Arizona and AT&T Illinois tariff rates. Margins defined as "Special Access Rate divided by UNE Rate minus 1." Table reflects pricing flexibility special access rates. Pricing flexibility rates for both local and transport channels elements apply in Phoenix MSA.*

*** – Effective 7/1/10: Per Tariff AT&T Illinois FCC No. 2, Section 21, pp. 755.1, 757, 759, 783 and 784,"[t]emporarily reduced rate pursuant to the AT&T/BellSouth Merger Commitment No. 6 of the F.C.C. Memorandum Opinion and Order, WC Docket No. 06-74, in The Matter of AT&T, Inc. and BellSouth Corporation Application for Transfer of Control. Customers subscribing to or renewing term plans from April 5, 2007 through June 30, 2010, will be charged the rates in Section 21.5.2.7.1 effective July 1, 2010."*

As shown in the table above, special access rates of both Qwest and AT&T exceed cost-based rates of their functional UNE equivalents by very large margins. For example, Qwest's intrastate special access rates for services

purchased on a month-by-month basis[75] range from 63% (DS1 local channel) to 1496% (DS1 transport mileage). This means that the DS1 rate is 1.63 times its economic cost and the DS1 transport mileage rate is almost 15 times its economic cost. Similarly, intrastate special access rates for services purchased on a 60-months term contract range from 45% (DS1 local channel) to 1070% (DS1 transport mileage). Qwest's interstate special access margins are generally of similar order. AT&T's interstate special access margins are also very high, with sixteen out of the total twenty margin measures in this table being in triple or quadruple digits.

These high margins translate into very large total dollar amounts. Specifically, Qwest Arizona and AT&T Illinois each earn special access services revenue in the vicinity of a *half a billion* dollars annually.[76] Table 3 below shows a broader, nationwide view by depicting the annual 2008 revenue for the RBOCs (Qwest, AT&T and Verizon), as well as Arizona's largest rural ILEC, Frontier, compared to the annual 2008 revenue for the Joint CLECs.[77]

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[75] Month-by-month special access rates are typically the highest special access rates available. They represent the closest contract terms when compared to UNEs because UNE products are leased on month-to-month basis.

[76] Based on the most recent data available (which is ARMIS report 43-04, row 4012 for year 2007), Qwest Arizona annual special access revenue subject for separations (interstate and intrastate) was $415,659,000, and AT&T Illinois's annual special access revenue subject for separations was $624,611,000.

[77] All companies, except for Integra, are publically traded and thus file revenue annually with the SEC. Their revenues were compiled from their 10-K and/or Annual Reports for 2008. Integra's revenue is based on a news release where it stated it had nearly $700 million in revenue in 2008 (see 2/10/09 press release at http://www.integratelecom.com/about/news/press_releases.php).

Table 3. Comparison of Annual Revenue Natiowide (2008)

Company	2008 Annual Revenue (millions)	% of AT&T Revenue	% of Verizon Revenue	% of Qwest Revenue
Integra	$700	0.6%	0.7%	5.2%
Paetec	$1,570	1.3%	1.6%	11.7%
tw telecom	$1,159	0.9%	1.2%	8.6%
XO	$1,478	1.2%	1.5%	11.0%
Frontier	$2,237	1.8%	2.3%	16.6%
Qwest	$13,475	10.9%	13.8%	100.0%
AT&T	$124,028	100.0%	127.4%	920.4%
Verizon	$97,354	78.5%	100.0%	722.5%

As shown in Table 3 above, on a nationwide scale[78] all four joint CLECs are significantly smaller than AT&T, Verizon or Qwest, and even smaller than Arizona's largest rural ILEC, Frontier. Because *total* revenue of a CLEC such as Integra Telecom constitutes a very small fraction of the RBOCs revenue, this underscores the point I made above: That the regulators' priorities should be to address above-cost rates of large ILECs rather than spend energy on the subject of CLEC access rates – the subject that is, while important for each individual CLEC, has a very small overall impact on the Arizona telecommunications market.

[78] There is no public data to make a similar comparison for the state of Arizona.

If Cost is Not Used to Set Access Rates, then for CLECs Competing in the Qwest Territory, Qwest's 1999 Access Rates Should be Used

Q. IF THE COMMISSION ELECTS TO ESTABLISH A BENCHMARK FOR CLEC ACCESS RATES OTHER THAN COST, WHAT SHOULD THAT BENCHMARK BE?

A. If this Commission does decide to mandate CLEC access rate reductions with a target other than cost, then the Commission should establish a benchmark rate for CLECs competing in the Qwest territory equal to Qwest's intrastate switched access rates from the 1999 time period. First, this is the time period when most CLECs were entering the competitive market. These rates would have been considered when CLECs made the determination on whether they could enter and compete in local markets. In addition, as discussed previously, changes to these rates since 1999, were the result of a series of revenue neutral settlement agreements entered into by Qwest for Qwest's benefit. There is no justification to apply reductions agreed to by Qwest to Qwest's competitors. Finally, it should also be noted, that when reviewing the rates in table 1, most CLECs, including the CLEC operations of AT&T and Verizon have rates that are similar to the rates that existed for Qwest in 1999.

Q. PLEASE SUMMARIZE ISSUE 2.

A. Carrier-own cost is the only reasonable benchmark for its access rates. Qwest's intrastate and interstate access rates were set based on horse-trading

considerations, and as such, are not based on Qwest's cost. However, even if Qwest's rates *were* set based on Qwest's cost, these rates and cost have no correlation to CLECs (or rural ILECs) cost. As new entrants, CLECs (as well as small ILECs) lack the economies of scope and scale enjoyed by the Bell Companies, and therefore, have higher access cost than RBOCs. Reducing CLEC access rates to RBOC rates would impose great economic harm on CLECs – carriers who could not possibly make up for lost access revenues via increases solely in end user charges. The Commission should discard calls to use Qwest's intrastate or/and interstate switched access rates as benchmarks for other carriers.

Issue 3. What procedures should the Commission implement to achieve the desired reduction in access rates?

Reduction in Access Rates Should be Implemented Gradually to Allow LECs Adequate Opportunity to Adjust Their Business Plans

Q. WHY SHOULD THE COMMISSION IMPLEMENT ACCESS RATE REDUCTIONS GRADUALLY?

A. The Commission should implement access rate reductions gradually over a time period sufficient for LECs to adjust their business plans. This is particularly important because carriers at issue in this proceeding are small carriers (when compared to Qwest – see table 3 above), and therefore, have smaller financial resources and less of an ability to absorb financial losses than a large company

such as Qwest. Similarly, to the extent access rate reductions cause increases in end-user rates, gradual transition would help cushion the impact of the reform on end-users and minimize market disruptions. A sufficiently long transition period would also allow LECs the opportunity to develop their switched access cost studies, which, as I discuss above, are the only proper measure of the reasonableness of rates.

There are many examples of gradual implementation of access reductions. For example, in its FNPRM on Intercarrier compensation,[79] the FCC proposed a 10-year transition period of intrastate switched access rates to the levels envisioned by the FCC.[80] In the *CLEC Access Charge Order* and *CALLS Order* the FCC adopted a three-year transition period.[81]

Q. WHAT SHOULD BE THE DURATION OF THE TRANSITION PERIOD AND THE TRAJECTORY OF RATE REDUCTIONS?

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[79] In the Matter of *High-Cost Universal Service Support*, WC Docket No. 05-337, *Federal-State Joint Board on Universal Service* , CC Docket No. 96-45, *Lifeline and Link Up*, WC Docket No. 03-109, *Universal Service Contribution Methodology*, WC Docket No. 06-122, *Numbering Resource Optimization*, CC Docket No. 99-200, *Implementation of the Local Competition*, CC Docket No. 96-98, *Provisions in the Telecommunications Act of 1996*, CC Docket No. 01-92, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 99-68, *Intercarrier Compensation for ISP-Bound Traffic IP-Enabled Services*, WC Docket No. 04-36, *Order On Remand And Report And Order And Further Notice Of Proposed Rulemaking*, released November 5, 2008 ("FNPRM").

[80] FNPRM, Appendix A, ¶¶192-196. While the FNPRM proposed a 10 year transition, it did not mitigate the impact of proposed rate changes by smoothing out reductions over the transition. Instead the FNPRM proposed the most substantial reductions in the first two years and minor reductions thereafter. A 10 year transition of this nature does little to allow CLECs the ability to rationally adjust and plan its business.

[81] See *CLEC Access Charge Order*, Appendix B "Final Rules," and 47 C.F.R. § 61.26(c) and See *CALLS Order*, ¶¶30, 35 and 196.

A. The Commission should recognize that a flash cut from one regime to another could cause massive marketplace disruptions to Arizona carriers and end-users. To minimize these disruptions, the Commission should set the duration of the transition period to be *at least* five to seven years. More importantly, the Commission should not mandate any reductions in the CLECs access rates *for the first three years.* This is necessary because, as explained in McLeodUSA comments,[82] CLECs will require a longer period to adjust their business plans due to the nature of their existing customer base: CLECs serve primary business markets and typically have long-term contracts with their business customers. McLeod explains that it has service agreements with virtually 100% of its existing business customers, with average service agreement being 4.2 years.[83] Because prices that CLECs charge end-users are often fixed during the term of the end-user agreement, CLECs would not be able to increase end-user prices for existing term customers to compensate for lost access revenue. In contrast, ILECs are more likely to rely on month-to-month end user pricing, meaning that they have the ability to quickly increase end-user rates if allowed to do so by the Commission.

Many LECs purchase long distance at wholesale from carriers such as AT&T and Verizon. These contracts can contain term commitments and pricing that are not dependent upon changes in access rates. As a result, if access reductions are

[82] McLeodUSA Statement of Position dated October 7, 2008.

[83] McLeodUSA Statement of Position dated October 7, 2008, p. 3.

mandated by this Commission with immediate implementation, LECs may end up paying wholesale rates that do not reflect these reductions. It is my understanding that IXCs have not committed to flow through access reductions to Arizona carriers or end users using the IXCs network. Immediate implementation of reductions could result in a windfall, not just from the reduction in rates, but the fact that wholesale long distance rates would not be immediately reduced to reflect the cost reductions.

Another factor that can aggravate the CLECs' situation is that business customers can generate higher calling (and access) volumes than residential customers. In other words, because of the nature of CLEC customers (who are predominantly business customers), CLECs could be more vulnerable to mandatory access rate reductions than a typical ILEC that serves higher portion of residential (low volume) customers.

Access Rate Reductions Should be Implemented in Separate Proceedings on a Case-by-Case Basis

Q. IF THE COMMISSION DECIDES TO MANDATE ACCESS RATE REDUCTIONS, WHY SHOULD THESE REDUCTIONS BE IMPLEMENTED IN SEPARATE PROCEEDINGS?

A. Initially, the Commission should decide on the policy issues, such as to what carriers intrastate switched access rate changes should apply, the appropriate

margins above cost the Commission will allow; target rates that the Commission may wish to impose in the event an access cost study is not available, the transition period, and how access cost recovery mechanisms, if any, will be established and funded. Decisions at each stage will affect the specifics of the implementation stage. For example, if the Commission decides that access charges should be cost-based, the carriers should be given the opportunity to produce switched access cost studies. The timing of individual carriers in producing cost studies would likely be different (because some carriers may have already have a cost study, and others may not); therefore, in makes sense to consider these cost studies in a separate docket.

Further, a record has not been developed upon which to base any assumptions about whether switched access charges contain implicit subsidies. The existence of and magnitude of such alleged subsidies should first be investigated and determined before any decisions affecting business (and likely, viability) of individual companies are made. Mandatory (potentially, confiscatory) rate reductions should not be implemented based on an assumption that has not been proven. Furthermore, even if such charges may include some implicit subsidies, the amount would likely depend on the cost structure and individual characteristics of each company. Because different companies have different unit costs due to economies of scale or other reasons, the amount or existence of such a subsidy cannot be assumed to be uniform.

In short, the Commission should avoid a "cookie-cutter" approach to access charges. The Commission should consider the unique characteristics of the various telecommunications providers, including the broad variations that occur between CLECs and rural ILECs in determining access charge policy.

Q. PLEASE SUMMARIZE ISSUE 3.

A. To summarize, in order to allow the carriers an opportunity to adjust their business plans, a transition period should be at least five to seven years, and no changes should be instituted earlier than three years out from whenever a final ruling becomes effective. Further, implementation of access reduction should proceed on a case-by-case, company-by-company basis.

Issue 4. Should carriers be permitted to contract for access rates that differ from their tariffed rates?

Carriers Should be Required to Pay Tariff Access Rates

Q. SHOULD IXCS BE REQUIRED TO PAY TARIFFED INTRASTATE SWITCHED ACCESS RATES?

A. Yes. Failure to require IXCs to pay tariffed access rates would only allow IXCs to exploit their market power in the access market.

Q. ARE YOU SAYING THAT LARGE IXCS HAVE SOME DEGREE OF MONOPOLY POWER IN PURCHASING ACCESS SERVICES?

A. Yes. Economists define such markets where a single or few dominant buyers can effectively set prices as "monopsonistic" or "oligopsonistic."[84] These concepts are similar to the more commonly used concepts of "monopoly" and "oligopoly" wherein a single or few *sellers* can influence prices. In monopsonistic or ologopsonistic markets dominant *buyers* can influence prices, and individual sellers have little choice but to accept prices and/or terms dictated by those buyers.

In access markets, a significant portion (60% or more) of all long distance traffic received by CLEC customers is carried to the CLEC networks by two IXCs, AT&T and Verizon. Further, because a CLEC (or any LEC) bills IXCs *after the* fact (for originating or terminating access service that has been provided), IXCs have an additional bargaining power because they can simply refuse to pay the bills. A CLEC (or any LEC) cannot refuse to terminate a call that has already been completed. Similarly, a CLEC (or any LEC) cannot refuse to terminate future calls from a non-paying IXC because by doing so, the CLEC will be doing disservice to its own end users.

Q. HOW WOULD THIS SCENARIO, IN WHICH IXCS AVOID PAYING CLEC ACCESS CHARGES, PLAY OUT IN THE REAL WORLD?

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[84] See F.M. Scherer and David Ross. *Industrial Market Structure and Economic Performance*, 3rd Edition, Houghton Mifflin Company, Boston, p. 17, noting that definitions of the buyers' market structures are "symmetric" to the definitions of the seller's market structures. Specifically, "[w]hen some buyers can perceptibly influence price, *monopsony* is said to exist." See also p. 79 noting that oligopsony is a market with few buyers.

A. Yes. This scenario does play out in real life:[85] A large IXC stops paying the CLEC's intrastate tariffed rate and informs the CLEC that it believes the switched access rate is too high – even if the rates have been tariffed and approved by the relevant state utility commission. Given that this IXC may by itself represent a large portion of the CLEC's total switched access revenue, unpaid invoices stack up quickly, resulting in a large unpaid balance and a significant drain on the CLEC's cash flow necessary for operations. In the end the CLEC is bullied into accepting partial payment for its access invoices to this IXC.

Issue 5. What revenue sources should be made available to carriers to compensate for the loss of access revenues?

Revenue Source Made Available to Compensate for Lost Access Revenue Should Not Lock Arizona Consumers into Support that May Not be Necessary in the Future

Q. IF THE COMMISSION DECIDES TO REDUCE LEC ACCESS RATES, SHOULD LECS BE GRANTED A REVENUE-NEUTRAL OFFSET OF

[85] Most recently, this scenario (where CLECs received rates lower than their tariff access rates from AT&T following AT&T refusal to honor tariff rates) was documented in the ongoing proceeding before the Colorado Public Utilities Commission docket No. 08F-259T *Qwest Communications Company, LLC, Complainant v. MCImetro Access Transmission Services, LLC, XO Communications Services, Inc., Time Warner Telecom Of Colorado, L.L.C., Granite Telecommunications, Inc., Eschelon Telecom, Inc., Arizona Dialtone, Inc., ACN Communications Services, Inc., Bullseye Telecom, Inc., Comtel Telecom Assets LP, Ernest Communications, Inc., Level 3 Communications, LLC, and Liberty Bell Telecom, LLC.* See also a 2004 proceeding in Minnesota *In the Matter of the Complaint of the Minnesota Department of Commerce for Commission Action Against AT&T Regarding Negotiated Contracts for Switched Access Services,* Docket Nos. P-442, 5798, 5826, 5025, 5643,443,5323,5668,466I/C-04.

THE LOSS IN ACCESS REVENUES STEMMING FROM THE COMMISSION'S DECISION?

A. Not automatically. While it is critically important to recognize that regulated rates should not be reduced without considering carriers' legitimate rights to recover their costs, carriers should not be given an automatic and *guaranteed* revenue-neutral offset. For example, granting revenue-neutral offset in the form of an access charge recovery fund (i.e. AUSF) would mean that Arizona consumers are locked forever (or until another Commission's action) into support levels that may not be necessary in the future. Specifically, shifts in population, technological advancements or other changes in conditions that affect cost of or demand for telecommunications services may reduce or eliminate the need for AUSF support for individual carrier.[86] As a result, a stream of support locked at historical levels would result in unwarranted (and undesirable from the public interest standpoint) subsidies for this carrier.

Q. WHAT REVENUES SHOULD THE COMMISSION MAKE AVAILABLE TO LECS TO COMPENSATE FOR LOSS IN ACCESS REVENUE STEMMING FROM THE REDUCTION IN ACCESS RATES?

A. There are two general types of potential revenue sources that carriers can use to compensate for the loss of access revenue: End-user rates or an access revenue

[86] As an example, ten or twenty years ago, a LEC was able to offer only voice telephony over its loop facilities. Today, loop facility can also carry high-speed Internet and video services. If a carrier starts offering such triple play products (voice/Internet/video), this carrier's revenue streams would increase significantly, likely eliminating the need to "subsidize" local service from public sources.

recovery fund, such as AUSF support. The advantage of the first source (from the standpoint of the public interest) is that is does not automatically lock Arizona consumers into current levels of "implicit subsidies:"[87] high local rates could attract competition, and rates could eventually be "competed down." The second source, AUSF, can be designed to allow support to fluctuate with the need, but this design would likely include high administrative costs.[88]

To summarize, when considering the source of revenue that the Commission may make available to compensate for lost access revenue, the Commission should not guarantee revenue-neutral offsets and should choose revenue sources that fluctuate in amount as need is verified. The Commission should recognize that whether access revenue recovery is achieved directly through end-user rate increases or a state access revenue recovery fund, ultimately end user customers in Arizona are going to pay for access cost reductions that primarily benefit the large IXCs.

Q. WILL CLECS BE ABLE TO BENEFIT FROM ANY ALTERNATIVE REVENUE STREAMS?

A. No. As explained below, if the Commission lowers CLEC switched access rates, CLECs will not be able to benefit from any alternative revenue streams the Commission may make available to the ILECs. This further underscores how

[87] I use the term "implicit subsidy" assuming that the Commission has made a determination that access rates paid to rural carriers exceeds the cost of providing the service.

[88] This design would require that the fund conducts periodic (such as annual) review of the LECs' financial need to funding.

inappropriate it is to benchmark CLEC switched access rates to those of the ILECs.

First, CLECs have limited ability to individually pass through rate increases to their customers. By definition, CLECs exist in competitive retail markets – CLECs are firms that enter markets already served by one or more carriers. The price in this market is generally already set by the existing players. No customer would switch to a CLEC's service unless it offers a competitive price and/or superior service. As a result, a CLEC cannot successfully raise end user prices, unless prices are increasing at the industry level – in other words, CLECs can only sustain price increases when all firms in the market increase price. Because CLECs are relatively small players in the market, compared with Qwest, the dominant provider, a CLEC will have very little success increasing prices unless Qwest is also increasing prices for that same customer class.

Second, it is unlikely, and not even advisable, that an access revenue recovery fund be established for CLECs to recover lost access revenue. As mentioned previously, these funds tend to take revenues that are subject to competition and lock them into a fund that will likely never be decreased. The value of such a fund in a competitive market is questionable. Further, I am not aware of any state that has established such a fund for CLEC access revenue recovery.

Issue 6. How much of access cost recovery, if any, should be shifted to end users? What showing should be required for such a shift? What should be the role of "benchmark" rates and how should benchmarks be set?

IXCs and Their Customers Are the Cost Causers of Traffic Sensitive Costs and Not End Users

Q. SHOULD THE TERM "ACCESS COST RECOVERY" AS USED IN ISSUE 6 BE CLARIFIED?

A. Yes. Issue 6 appears to mix two different notions – (1) recovery of access cost, and (2) recovery of non-access cost that is currently built into some access rates. Access rates *should* recover access cost; therefore, no shifting of access cost *away from* access rates should be done. Non-access cost that is currently built into some access rates do constitute a subsidy, and should indeed be the subject of this proceeding and Issue 6.

Q. WHAT ABOUT CERTAIN ACCESS COST ELEMENTS, SUCH AS THE COST OF LOCAL LOOP THAT IS OFTEN RECOVERED IN CARRIER COMMON LINE ("CCL") CHARGES?

A. The presence of a CCL does not automatically imply that this rate is a subsidy: The issue here is whether the *per minute* CCL charge properly recovers what could be *non-traffic-sensitive* cost. The traditional FCC view has been that loop is not a traffic-sensitive cost, and therefore, its costs should be recovered through a

per line charge.[89] However, even the FCC noted in its *Access Charge Reform Order*, when setting the federal flat-rated mechanism for common line cost recovery, that "[common line] costs should be assigned, where possible, to those customers who benefit from the services provided by the local loop." [90] The customers that benefit from the local loop[91] include IXCs and their long-distance subscribers. Therefore, it is reasonable to ask that IXCs share the cost of the loop in relative proportion to their use of the facility.[92] In other words, if an IXC bears no cost of the local facility that allows it to provide long-distance service, there would be a subsidy flow from local exchange services to an IXC who is provided access to the facility at no cost.

Q. DOES IT MATTER WHETHER THE COST IS RECOVERED FROM AN END-USER OR AN IXC GIVEN THAT IXCS ALSO SERVE END-USER AND MAY PASS THEIR COST SAVINGS ON END-USERS?

A. Yes, for a number of reasons.

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89 FCC, *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers , Transport Rate Structure and Pricing, End User Common Line Charges,* CC Docket No. 96-262, CC Docket No. 94-1, CC Docket No. 91-213, CC Docket No. 95-72, First Report and Order, adopted: May 7, 1997 ("Access Charge Reform Order") ¶37. This order sett the federal flat-rated mechanism for common line cost recovery.

90 Access Charge Reform Order ¶77.

91 While it is true that end-users benefit not only from actual usage, but also from the "ability" to make the call, it would be improper to completely disregard the first benefit (actual usage).

92 Another relatively recent development that further underscores the notion that local loop is a shared and potentially traffic-sensitive facility is that CLECs offer integrated voice and data services over shared local loop facilities in which bandwidth is *dynamically re-allocated* to either voice or data based on current demand/usage. If voice long-distance traffic uses the loop, the smaller portion of the loop bandwidth capacity can be allocated to data services.

First, as is well established as a regulatory principle: the cost causer should pay, lest undesirable subsidies are created. Given that end users are not a homogenous group but are differentiated between providers and services, it is critically important that regulators do not create subsidies between disparate groups of end users.

Specifically, the IXCs' end users are not the same as the CLECs' end users. For example, AT&T may serve a large telephone solicitor in Phoenix who calls residents in Tucson, including CLEC end users. There is no good justification for having the CLEC's end users subsidize[93] AT&T's telephone solicitor business by not assessing such calls the full long run incremental costs of such calls. Assuming that many of the CLEC's end users may actually find such calls annoying, it would be adding insult to injury to tell them they are in fact forced by this Commission to subsidize such nuisance calls.

In general, the IXCs' end users are the cost causers of long distance calls and the associated switched access costs. There is no policy rationale to having other end users – *who may make no long distance calls at all* – pay for the traffic sensitive costs of switched access. In fact, such a policy is tantamount to a cross-subsidy scheme.

[93] It is assumed here that benchmarked rates would not compensate CLECs for the costs of switched access services.

Further, it matters because IXCs would not necessarily pass these access cost savings onto Arizona end-users. In fact, IXCs are misleading the Commission with claims such as, "[t]he high access rates promoted by the current system obviously distort Arizona telecommunications prices:"[94] These claims are misleading because they create false appearance that IXC's in-state pricing in Arizona is linked to Arizona intrastate switched access rates. In reality, AT&T, for example, offers the *same* in-state calling plans in Arizona and states with "low" intrastate access rates, such as Nebraska and New Mexico.[95] While AT&T also charges an "in-state connectivity fee," this charge does not appear to have a link to intrastate access cost. Specifically, this fee is currently $1.49 in Arizona, $1.63 in Nebraska and zero in New Mexico.[96] Yet, AT&T comments are complaining that Arizona access rates are very high (citing average access rates of 3.1 cents for Qwest and 14 cents for Citizens[97]), and pointing out intrastate rates in New Mexico and Nebraska are at interstate levels (citing a 2-cent access rates for rural carriers in Nebraska and 1.83 cent state wide average rate in New Mexico[98]). Clearly, there is no direct relation between AT&T "in-state connectivity fee" and intrastate access rates because this fee is higher in Nebraska than in Arizona, and absent in New Mexico, despite the fact (as presented by

94 *Comments of AT&T* dated January 7, 2008, p. 2.

95 Using AT&T's web site (http://www.shop.att.com/plancomparison.jsp), I reviewed residential calling plans in several states. These pricing plans appear to be identical. Based on the notes to these plans, Alaska is the only state where in-state calling is slightly different than in other states.

96 See http://www.consumer.att.com/instate-connectionfee/.

97 *Comments of AT&T* dated January 7, 2008, p. 6.

98 *Comments of AT&T* dated January 7, 2008, pp. 9-10.

AT&T) that Nebraska and New Mexico have similarly "low" access rates, and Arizona has "high" access rates.

In other words, because AT&T in-state calling plans are priced at "generic" nationwide levels, a decrease in Arizona intrastate rates would likely not translate into a rate decrease for Arizona long-distance customers of AT&T. Instead, AT&T would simply pocket the access cost savings obtained at the Arizona consumer expense and use them to "subsidize" its operations in other states or simply flow through the savings to its shareholders.

Issue 7. Procedurally what will be required of a carrier if it seeks a "revenue neutral" increase in local rates?

Issue 8. Assuming that AUSF funds will also be used as a compensating revenue source, what specific revisions (including specific recommended amendment language) to the existing rules are needed to allow use of AUSF funds for that purpose?

Issue 9. What carriers should be eligible for AUSF support?

Issue 10. What should be supported by AUSF? Access replacement only? High cost loops? Line extensions? Centralized administration and automatic enrollment for lifeline and Link-up?

The Use of AUSF Should be Limited, and Recipient Carriers Should Have to Demonstrate the Need for Funding

Q. WHAT SHOULD THE COMMISSION CONSIDER WHEN DECIDING ON WHETHER TO USE AUSF AS A "COMPENSATION" FOR REDUCTION IN ACCESS RATES?

A. First, as noted with regard to Issue 6, the Commission should make a clear distinction between (1) recovery of access cost, and (2) recovery of non-access cost that is currently built into some access rates. Access cost should be recovered in access *rates*, not in AUSF. Shifting recovery of access cost to the USF would be contrary to the goal of a USF fund, which is typically to ensure connectivity to the network, and not to subsidize long-distance business.

Second, the Commission should make sure that any decision it makes regarding access revenue replacement through AUSF is *competitively neutral.* Granting revenue replacement for some carriers (ILECs) and not others (CLECs) is not revenue neutral: CLECs are price takers in competitive markets, meaning that they cannot increase its end-user rates beyond the market rates (and unless the ILEC increases its rates). In other words, if the ILEC access revenues are "replaced" by AUSF moneys, but CLECs competing with those same ILECs cannot draw from AUSF, they would not be able to "replace" their lost access revenue with increased end-user charges: If a CLEC attempts to do so, its end-users would migrate to the ILEC (carrier that does not need to increase its end-user rates to replace lost access revenue because it receives replacement support from AUSF).

Third, because of the competitive neutrality implications, the Commission should reject the notion of granting *revenue neutrality*. Instead, the Commission should focus on funding situations where the carrier has a real *need that is in public interest*: Subsidizing *high cost* areas and services for low income customers are indeed the cases of real need from the standpoint of public interest. Subsidizing out-of-state IXCs and extraordinary returns of ILECs are not cases of real need. Funding for line extensions (construction of loop facilities to areas outside the range of pre-existing outside loop plant) likely is unnecessary because extraordinary construction cost of line extensions are typically addressed in special construction tariffs.[99] Therefore, in order for a carrier to draw from the fund, it should be required to demonstrate the "public interest" need.

Q. PROCEDURALLY, WHAT SHOULD BE REQUIRED IN ORDER TO DETERMINE THE AMOUNTS OF AUSF SUPPORT FOR AN INDIVUUAL LEC?

A. Qwest proposes that before a carrier is eligible to draw money from the AUSF it should "first be required to make a showing, either through a R14-2-103 filing, or

[99] For example, section 14 of the Frontier Citizens Utilities Rural local tariff (*Telephone Service Tariff)* explains that if cost of construction of line extensions exceeds "normal conditions," the end-user will pay actual construction cost in excess of "normal" level. Specifically, at p. 2 it says as follows: "Under normal conditions, the Company, without charge, will extend its lines to reach applicants provided that the cost of constructing the required line extension will not exceed seven times the estimated annual exchange revenue from such applicant or applicants. ... If the line extension requirements of an applicant or group of applicants exceed the above, a construction charge will be made for the facilities in excess of the allowances specified above." It further explains on p. 3 that "[i] n those circumstances where extensions to outside plant facilities exceed the allowance in 14.1.2.a) above [seven times the estimated annual exchange revenue], the customer, in addition to any material or labor to be furnished by him, will pay in advance the estimated total cost of the Company's construction as prescribed in a contract executed between the Company and the customer."

through a simplified earnings review, that their earnings do not exceed the authorized rate of return."[100] The Joint CLECs support this proposal. Only if the ILEC exhausts all avenues of end-user rate increases, and the revenue is still insufficient to generate allowable rates of return, should the carrier be given AUSF support. Further, the amount of support determined from a rate proceeding or earnings review should not be guaranteed to the carrier indefinitely because technological advances, population shifts, introduction of new telecommunications products or other changes may eliminate the need for support in the future. Because the carrier/recipient of AUSF would have no incentive to disclose the fact that it no longer needs support, the Commissions should develop procedures that require recipient carriers to periodically update the data in the rate case that demonstrated the need for AUSF support.

Q. PLEASE SUMMARIZE ISSUES 7 THROUGH 10.

A. The fund should *not be a replacement for* loss of access revenue stemming from the reduction in access rates. Funding should be based on public interest need and limited to cases of high cost and low income support. Line extensions should not be funded to the extent the cost of their construction is recovered through the "special constructions" tariff provisions. In order to receive funding, a carrier should show the need. Before a carrier is allowed to draw from the AUSF, there should be a demonstration of need. The carrier-recipient of the fund should also

[100] *Qwest Corporation's Reply Regarding Matrix Issues and Procedural Recommendations*, October 7, 2008, p. 2.

be required to periodically refresh the data used to justify support in order to demonstrate to the Commission that it continues to need AUSF support.

Issue 11. What should be the basis of AUSF contributions and what should be the structure of any AUSF surcharge(s)?

Q. WHAT SHOULD BE THE BASIS OF AUSF CONTRIBUTIONS?

A. Qwest notes that funding "should come from all sectors of the industry, i.e. ILEC, CLEC, Cable, Wireless and VOIP providers..."[101] The CLECs agree with this proposal. The CLECs disagree with Qwest's proposal calling for the Arizona Commission to automatically follow the FCC, should the FCC changes its method to fund the federal USF.[102] Specifically, AT&T's and Verizon's federal advocacy is to move USF contribution to a numbers based system. Since IXC operations typically do not have many, if any, telephone numbers, this proposal essentially excludes IXC operations doing business in Arizona from contributing to the AUSF. Instead, the Commission should carefully consider changes enacted by the FCC to assure that customers are not assessed twice for USF contributions (State and Federal) on the same revenue.[103]

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101 *Qwest Corporation's Reply Regarding Matrix Issues and Procedural Recommendations*, October 7, 2008, p. 4.

102 See *Qwest Corporation's Reply Regarding Matrix Issues and Procedural Recommendations*, October 7, 2008, p. 4; *Issues Matrix Arizona Local Exchange Carriers Association*, October 7, 2008, p. 5; *AT&T's Issues Matrix and Procedural Recommendations*, October 7, 2008, p. 5; and *Verizon's List of Issues*, October 7, 2008, p. 4

103 *McLeodUSA's Statement on Issues*, October 7, 2008, p. 4.

IXCs pay intrastate switched access today in order to originate and terminate long distance calls made by IXC customers. Creating a fund based on all carriers intrastate revenues has the effect of requiring all carriers in the state, even those that do not do business in the areas receiving access-related funding, to subsidize IXCs' customers. In other words, where previously IXCs such as AT&T and Verizon paid rural carriers when AT&T and Verizon's customers made toll calls to rural areas, they now propose that CLECs contribute to an access revenue recovery fund for the benefit of AT&T's and Verizon's customers to originate and terminate calls to rural ILECs. The Joint CLECs find this problematic unless there is a clear showing that the AUSF is for the purpose of *universal service* (rather than a pure benefit of IXCs), and carriers drawing from the fund have demonstrated need as proposed by Qwest.

Issue 12. Any other specific revisions to the AUSF rules.

Q. DO THE JOINT CLECS HAVE ANY PROPOSED REVISIONS TO AUSF RULES AT THIS TIME?

A. No.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.